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SUBJECT: VIETNAM'S ECONOMY Q3 2009: STRONG RECOVERY, CONTINUING RISKS

¶1. (U) Summary. Vietnam's economic growth during the third quarter continued to accelerate, aided by the Vietnamese Government's (GVN) economic stimulus program. Growth of gross domestic product (GDP) for the first nine months was up 4.6% and is now expected to reach 5.2% for 2009, which will make Vietnam one of few countries with a positive growth story this year. Exports contracted, however, and were down 14.3%. Though imports fell by 25.2%, Vietnam's trade deficit over the first nine months still showed a deficit of $6.5 billion, which has contributed to a drop of about 23.5% in foreign exchange reserves this year to $17.6 billion. The value of licenses granted for new or expanded foreign direct investment (FDI) projects dropped a dramatic 78.6% through the third quarter, but actual FDI disbursements fell only 11.2% over the same period. Consumer price inflation has remained under control, up only 4.11% through the third quarter. While the worst turmoil from the global financial crisis appears past, on October 30 the GVN announced its decision to extend its economic stimulus plan (septel) into 2010, though with a narrowed scope. Balancing the political drive for growth motivated by the upcoming Party Congress in January 2011 with the need for consumer price stability will remain a difficult challenge for the GVN in the remaining months of 2009 and 2010. End summary.

Accelerating Quarterly Growth

¶2. (U) Vietnam's economy appears to have survived the worst of the economic crisis. While GDP grew at only 3.1% in the first quarter of 2009 - the slowest growth in a decade - it accelerated in the second and third quarters to 4.5% and 5.8%, respectively. Consumer confidence is on the rise and Vietnam now ranks as the fourth most confident country in the world, up five places since March this year, according to a September survey by the Nielsen company. If growth during the fourth quarter reaches 6.8%, as forecast, the GVN is likely to meet its target of 5% GDP growth for 2009 and may even reach the 5.2% estimate of the Ministry of Planning and Investment (MPI). Though GDP growth is the lowest in a decade, Vietnam has still outperformed most of its neighbors and is expected to be one of the few economies in the world with positive growth this year. Current GDP growth projections for 2010 range from 6.5% (GVN) to 8.5% (Credit Suisse).

Strong but Unbalanced Stimulus Impact

¶3. (U) Despite Vietnam's apparent strong recovery, many government officials and economists have expressed concerns about the sustainability and quality of this growth. Growth has been largely dependent on real estate and construction investment, partly driven by the government's stimulus plan. The efficiency of this capital

spending has been subject to criticism. Meanwhile, growth in the agricultural, forestry and fishery sectors - employing more than 60% population of Vietnam - has lagged behind at 1.6%, while processing industries have risen modestly at 2%.

¶4. (U) Benefiting from the stimulus package, construction experienced an impressive turnaround - from a 0.4% contraction last year, to 9.7% growth in the first nine months of this year - thanks to the increase in investment projects in the stimulus package, as well as to a fall in the prices of construction materials and the recovery of the real estate market. Anecdotal reports, as well as testimony in the National Assembly, indicate that while the 4% interest rate subsidy included in the stimulus package was not intended for real estate development, this subsidy played an important role in fostering growth in the real estate sector through freeing up funds in many large corporations. Meanwhile, industrial production through the third quarter grew by 6.5%, of which, mining production rose by 9.8%, manufacturing by 6.1%, and electricity, gas and water by 10.2%.

¶5. (U) Growth in consumer spending and the service sector has also played a key role in the recovery of the economy. Sales of consumer goods and services for the first nine months rose 18.6%, at around $47 billion; even discounted for inflation, sales still

rose 10.2%. Financial services, benefitting from subsidized interest rates under the stimulus program, grew by 8.1%. Tourism, however, has suffered from the global downturn and is down by 16%, with around 2.8 million international visitors during the first nine months of 2009.

First Export Contraction in 14 Years

¶6. (U) Exports declined for the first time since 1995, dropping 14.3% during the first nine months to $41.7 billion - a figure which would have been worse if not for large exports of gold previously purchased as a hedge against the 23% inflation of 2008. The GVN's 3% export growth target for 2009 is now considered out of reach, and an annual contraction of between six and nine percent is likely, according to the Ministry of Industry and Trade (MOIT). The MPI forecasts an export contraction of as much as 10%. This contraction has been caused by price - not volume - declines following the fall in global commodity prices, especially for agricultural and mineral products. Had commodity prices not plunged, Vietnam would likely have seen 1-2% growth over this same period. Export volume increased 10.7% through the third quarter, with most exports up over the past nine months, including: crude oil (up 8.6%), rice (up 34%), coffee (up 14%), pepper (up 52%), and cassava (up 194%). Export prices, however, fell by 22.5% over the same period.

Losing Control of the Trade Deficit and Forex Reserves?

¶7. (U) Vietnam's trade deficit through the third quarter was reduced to 41.2% of the deficit for the same period last year, down to $6.5 billion. This was largely because imports were down 25.2% to $48.3 billion, due to both price and volume factors. However, the third quarter alone contributed $4.5 billion to the deficit (almost 70%) and this suggests growth in the trade deficit may be accelerating as the economy picks up. Except for wheat and pharmaceuticals, imports of all leading products fell, including: oil and petrol (down 52.6%), iron and steel (down 35.5%), automobiles (down 23.9%), clothes (down 8.7%), and materials for

textile and footwear industries (down 23.7%).

¶8. (U) Because of the trade deficit, reduced foreign investment, and decreased overseas remittances, Vietnam's foreign currency reserves have fallen dramatically from $23 billion in December 2008 to about $17.6 billion in June 2009, according to Asian Development Bank estimates (GVN figures are not made available). The forex market remains fragile, with a lack of dollar liquidity and a continuing lack of confidence in the Vietnamese Dong (VND), given historically high inflation rates. Rationing its forex reserves, the State Bank of Vietnam (SBV) has kept tight control of dollars needed to finance imports and has restricted the official USD-VND trading band to five percent around the official reference rate. At the same time, exporters have held on to their dollar receivables because of concerns regarding inflation and potential depreciation. The VND continues to trade at the weaker end of the official trading band.

¶9. (U) As a result, the SBV is tapping International Finance Institutions (IFIs) and donor countries for overseas development assistance (ODA) to support its forex reserves. In the past months, the GVN has announced some $5 billion in planned borrowing to support its forex reserves, including: $1 billion per year in "soft loans" from Japan for 2010-2012; $1 billion from the World Bank; $500 million from the ADB; as well as and an additional $500 million loan from Japan.

FDI Likely to Meet Target Despite Downturn

¶10. (U) The estimated total future value of licenses for new

licensed or expanded FDI projects approved during the first three quarters is down 78.6% at $12.6 billion, with newly licensed projects falling 85.7% to $7.7 billion. However, additional investment licenses issued for existing projects increased slightly by .07% to $4.9 billion, suggesting that existing investors remain optimistic about their prospects in Vietnam. Because the GVN relies primarily on FDI commitments as measured by the estimated total future value of licensed projects, official FDI numbers are hard to confirm and often dramatically overstate the real investment likely to be realized in the foreseeable future, particularly in the area of hospitality investments. Despite the uncertainty in official FDI figures, however, Vietnam remains an attractive destination for foreign investors in general and American investors in particular. As of the end of the third quarter, the US was Vietnam's largest investor in 2009, accounting for 79.1% of total value of FDI licenses issued. Vietnam appears likely to reach, on paper, its 2009 target of $20 billion worth of licenses issued for FDI projects by October, if one includes the recently announced $4.15 billion resort in Quang Nam and the $2 billion new town project in Dong Nai.

Inflation Restrained, But Pressure Mounting for 2010

¶11. (U) Average CPI during the first nine months of 2009 rose by 4.11%, but has accelerated recently, rising 0.62% in the month from August to September. The GVN still projects annual inflation will remain within 7% for 2009 and has stated that inflation is not a concern in the short term. However, price pressures will likely mount in the medium and long term as the government's stimulus package, particularly the 4% interest rate subsidy on various types of bank lending, increases credit growth and economic activity. Other factors, including a proposed increase in minimum wages and

the recovery of world commodity prices in 2010, will also likely create inflationary pressure next year.

Growing Government Debt

¶12. (U) Besides the threat of inflation, there are concerns about how Vietnam will finance its increasing budget deficit. As a result of tax cuts and deferments under the stimulus package, government revenue has dropped while spending has risen. Vietnam's budget deficit is expected to widen from 4.1% of GDP in 2008 to 10.1% of GDP in 2009, according to ADB predictions; the GVN itself estimates a deficit of 6.9%. At the same time, the GVN has held five failed government bond offerings this year and Vietnam's government debt is forecast by the National Assembly Budget and Finance Committee to rise to 40% of GDP in 2009, up from 36.5% in 2008, and increasing to 44% of GDP in 2010.

Comment

¶13. (SBU) Given the global economic environment, the Vietnamese economy has performed remarkably well in 2009 and it is likely the GVN will achieve its (revised) 2009 GDP growth target. At the same time, the GVN leadership will feel pressure to reach politically significant short-term economic growth targets in the run-up to the upcoming 11th National Congress of the Communist Party in 2011, which may complicate efforts to ensure macroeconomic stability. The recent decision to extend the stimulus package, albeit in narrower form, despite warnings from a number of economists that rapid credit growth will fuel inflation, suggests that political considerations are foremost in current macroeconomic policymaking.

¶14. (U) This message was coordinated with Consulate Ho Chi Minh City.
Palmer